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IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1982

NO. _____

MALLETTE BROS. CONSTRUCTION CO., INC.,)
GAUTIER ASPHALT COMPANY, INC.) *Petitioners*
MALLETTE BROS. TRUCK LINES, INC.)
(Consolidated Cases)

V.

UNITED STATES OF AMERICA, Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

C. Everette Boutwell
P.O. Box 4448
Laurel, Mississippi 39440
(601) 649-3221

Counsel For Petitioners

May 27, 1983

QUESTION PRESENTED

The sole question presented is whether the standard of sufficiency of evidence for granting a motion for a directed verdict established by the U.S. Fifth Circuit Court Of Appeals conflicts with and substantially overreaches the standard promulgated by the U.S. Supreme Court and the Seventh Amendment to the U.S. Constitution.

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(Consolidated Cases) Petitioners

v.

UNITED STATES OF AMERICA, Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners Mallette Bros. Construction Co., Inc., Gautier Asphalt Company, Inc. and Mallette Bros. Truck Lines, Inc. respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court Of Appeals For The Fifth Circuit entered in this proceeding on March 2, 1983.

OPINION BELOW

The opinion of the Court Of Appeals,

which appears in the Appendix hereto, is reported at ___ F.2d ____ (1983), 83-1 USTC ¶ 9144 .

JURISDICTION

The judgment of the Court Of Appeals For The Fifth Circuit was entered on January 14, 1983. Petitioners filed their Petition For Suggestion For Rehearing En Banc, which was denied on March 2, 1983. This petition for certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. Section 1254(1).

QUESTION PRESENTED

The sole question presented is whether the standard of sufficiency of evidence for granting a motion for a directed verdict established by the U.S. Fifth Circuit Court Of Appeals conflicts with and substantially overreaches the standard promulgated by the U.S. Supreme Court and the Seventh Amendment to the U.S. Constitution.

STATUTORY PROVISIONS INVOLVED

United States Code, Title 45: (FELA)

Section 51 et seq.:

The employer shall be liable for damages **** for such injury or death resulting in whole or in part from the negligence of any of the officers, agents, or employees * * * of the carrier.

While this statute is significant to the case herein, its importance lies in its relationship to the cases of this Court and of the U.S. Court Of Appeals For The Fifth Circuit that have set the standard of evidence for granting a motion for a directed verdict in each of the two Courts. Many if not all of such cases refer to 45 USC Section 51 Federal Employers' Liability Act (FELA) as a point of reference from which to proceed in arriving at an evidence standard. Jones Act (46 U.S.C. Sec. 688) cases are similarly referred to in many of the same cases for the same reason.

STATEMENT OF THE CASE

The U.S. Fifth Circuit Court of Appeals granted directed verdicts to the Government, citing Boeing Co. vs Shipman, 411 F.2d 365 (CA5, 1969) as its standard for the sufficiency of evidence to make a jury question, which it contends petitioners did not meet.

U.S. District Judge Walter L. Nixon, Jr., had previously ruled in favor of petitioners and against the Government in denying the directed verdicts, also citing Boeing Co. vs Shipman as the standard used in denying the directed verdicts.

Neither Court considered or used the Brady rule established by the U.S. Supreme Court in Brady vs Southern R.R. Co., 320 US 476, 64 SCT 232, 88 L. Ed. 239 (1943) as the standard for the test of the sufficiency of evidence in connection with directed verdicts and judgments N.O.V.

Petitioners contend that the U.S. Supreme Court standard should be used instead of the Fifth Circuit standard.

The Fifth Circuit contends in Boeing that the Supreme Court has not decided a standard, except for Fela and Jones Act type cases.

Petitioners contend herein that Brady is the proper standard.

The U. S. Fifth Circuit Court Of Appeals established its own test of the sufficiency of evidence required to create a jury question in Boeing Co. vs Shipman, 411 F.2d 365 (CA 5, 1969), the "conflict of substantial evidence" rule, and at the same time announced that it would no longer follow the U. S. Supreme Court test established in Brady vs Southern RR Co., 320 US 476, 64 S Ct 232, 88 L Ed 239 (1943), referred to as the "one reasonable conclusion" test and as the Brady rule. The Fifth Circuit further announced that the Brady rule would only be considered in FELA and Jones Act cases.

Although it is the undisputed Law Of The Land that U. S. Supreme Court decisions take precedence over all others, the Fifth Circuit handled this in Boeing with the comment that the Supreme Court has never ruled specifically as to what type of cases the Brady rule should be applied to.

In the case at bar, the Fifth Circuit mis-applied even its own Boeing rule in taking away a jury's verdicts, an act which it would in no wise be able to justify even under the strictest interpretation of the Brady rule.

The U. S. Fifth Circuit Court Of Appeals reversed the District Court's judgments for the Petitioners and overturned the jury's verdicts favorable to the Petitioners, stating as its reason that there was "no credible evidence" presented on behalf of the Petitioners.

At trial, Petitioners' chief witness was a certified public accountant (CPA) who testified extensively as to why the IRS income tax assessment was erroneous, and concluded with the amount of tax refunds due to the Petitioners. The Government's chief witness was the IRS Agent who made the tax examination that led to the assessment. His testimony was directed toward defending his tax examination.

The Fifth Circuit panel did not consider the testimony of the two chief opposing witnesses to be a "conflict in substantial evidence" sufficient to create a jury question, citing its standard for sufficiency of evidence in Boeing Co. vs Shipman 411 F.2d 365 (CA5, 1969) as the test, without considering the "one reasonable conclusion" test of Brady vs Southern RR Co 320 US 476, 64 S Ct 232, 88 L Ed 239 (1943).

This Petition involves three federal income refund suits, consolidated by the trial Court for purposes of trial, brought by Petitioners seeking to recover about $60,000.00 in taxes paid as the result of an IRS audit of the three corporations for their fiscal years ending in 1972 and 1973. All of the IRS assessment involved intercompany transfers of funds among the three corporations, all of which were made due to the shortage of working capital in the three corporations, all of which had been in business for only a short time, and all of whose capital stock was owned equally by the Mallette brothers, Glynn and Moseley.

Without any bookkeeping, accounting or tax training, the Mallette brothers relied on their outside accountant to handle and guide them as to their bookkeeping and accounting, and to prepare their tax returns. The accountant died during the time period covered by but prior to the IRS audits, and a CPA was engaged to help them, but he moved to Texas just as the IRS audits were being concluded, and again they had to find another accounting firm. All of this disruption either left the Mallettes without representation during the course of the IRS tax audits, or at best with represen-

tatives not familiar enough with the case to question the audit results.

When demand for payment was made by the Internal Revenue Service, the Mallettes re-financed their businesses with a finance company and paid the tax and interest in full.

Thereafter legal tax counsel was engaged, and timely claims for refund were filed for each of the corporations, on the grounds that the federal income taxes assessed and collected as the result of the IRS audit were improperly, illegally and unlawfully collected. The IRS denied all of the refund claims.

The Construction company and the Asphalt company had done business with each other, and the claims of both companies asserted that neither had been given deductions or credits for asphalt purchases and payroll paid for with intercompany transfers of funds between the two companies.

The Trucking company had not done business with the Construction company or the Asphalt company, but the Construction company had transferred funds to the Trucking company as loans, according to the

testimony of Glynn Mallette, and the claim for refund stated that the Trucking company had not been given credit for the funds. The IRS had included them in the taxable income of the Trucking Company.

Glynn Mallette testified that after the claims were denied, he received a telephone call from the Internal Revenue Service, informing him that if he insisted on pursuing the refund claims, his corporations would be audited again. The claims were pursued and the Corporations were audited again for subsequent years.

Refund suits for each of the three corporations were filed in the United States District Court for the Southern District of Mississippi, Biloxi Division, and the cases were assigned to Walter L. Nixon, Jr., Chief Judge, who ordered the cases consolidated for trial.

In the Construction company, numerous bank deposit tickets were introduced into evidence, showing that payments received from customers were entered on the tickets, sub-totaled, and showing "cash withheld" being subtracted from the sub-total, in every instance with the number of another bank account being

written by the subtracted amount to show which bank account the "cash withheld" was being deposited in. In every instance there was a matching bank deposit ticket bearing the referenced account number and showing that the "cash withheld" was deposited as indicated. In some instances, the "cash withheld" would be transferred to a payroll account for the payment of payroll, and in other instances it would be transferred to a bank account of the Asphalt company to pay for asphalt purchases from the Asphalt company by the Construction company. Petitioners stipulated at trial that all such "cash withheld" was properly income the Construction company should have reported, but further contended that the Construction company should be allowed deductions for the payroll and asphalt purchases for which the "cash withheld" was spent. (The use of the term "cash withheld" in this case is actually a misnomer-practically all of the payments received from customers were in the form of checks, all of which were deposited. None were "cashed" at the bank, and the two deposit-ticket system was merely a way to divide the funds up be-

tween two different bank accounts. The same thing would have been accomplished by depositing all of the funds into one bank account, and writing a transfer check from one bank account to another. No actual "cash" was handled in making all of these transfers from bank account to bank account.)

At trial the Government conceded that the funds were spent for payroll and asphalt, and conceded that both such items are properly deductible expenses, but contended that the Construction company had already deducted and received credit for the expenses. Petitioners' expert witness Alexander, a CPA, testified that the deductions and credits had not been allowed.

In the Asphalt company, the IRS audit added about $37,000.00 to income, representing credit sales of asphalt to the Construction company. Petitioners' expert witness CPA testified that Construction was not given credit for this intercompany charge and that it was improper. The Government contended that credit had been allowed (as a "net" item offset included in some other adjustments).

In the Trucking company, it had re-

ceived several checks from the Construction company, and at trial contended they were loans. The Government argued that they were payments for the purchase of fuel. It also objected to the testimony of Petitioners and their experts as to the items being loans, on the basis that such a contention amounted to a "variance" from Petitioners' claim for refund, and was therefore not admissable.

The consolidated cases were tried before a jury, and at the end of the trial the Government prepared interrogatories, which were approved by the Court and by Petitioners' counsel, for submission to the jury to be used by the jury in stating its verdict.

The jury found for Petitioners in all three cases, and the District Court entered judgment in favor of taxpayers on all issues.

The Government had made motions for directed verdicts after Petitioners rested their case and prior to the submission of the case to the jury. All were overruled.

On the last day for doing so the Government filed separate motions seeking judgment not withstanding the verdict,

all of which were overruled by the District Court.

The Government appealed to the U. S. Court Of Appeals For The Fifth Circuit, and oral arguments were held before Circuit Judges Wisdom, Tate and Randall.

The Panel reversed the District Court and overturned the jury verdict in each of the three cases.

Circuit Judge Carolyn Randall presided at the oral arguments and wrote the opinion, which held that: (1) the evidence did not support the jury verdicts in favor of the taxpayers, and (2) that it was error for the District Court to submit to the jury an issue not raised in one (Trucking company) taxpayer's claim for refund. In the opinion Judge Randall stated that directed verdicts should have been given in favor of the Government as to the Construction company and the Asphalt company due to the lack of credible evidence to support the jury verdicts, and that it was reversible error as to the Trucking company claim to allow testimony that amounted to a "variance" concerning the loans.

REASONS FOR GRANTING THE WRIT

1. THE DECISION BELOW CONFLICTS WITH THE DECISIONS OF THE SUPREME COURT OF THE UNITED STATES AS TO THE PROPER STANDARD FOR GRANTING DIRECTED VERDICTS.

A verdict will normally be directed where both the facts and the inferences to be drawn from the facts point so strongly in favor of one party that the court believes that reasonable men could not come to a different conclusion.

(a) U. S. Supreme Court Standard.

The decision in Brady vs Southern Railroad Co. 320 US 476, 64 S Ct 232, 88 L Ed 239 (1943) announced the standard in the following terms:

"When the evidence is such that without weighing the credibility of the witnesses there can be but one reasonable conclusion as to the verdict, the court should determine the proceeding by non-suit, directed verdict or otherwise in accordance with the applicable practice without submission to the jury, or by judgment notwithstanding the verdict. By such direction of the trial, the result is saved from the mischance of speculation over legally unfounded claims."

This Court again spoke on the standard for granting directed verdicts in Tennant v Peoria & Pekin Union Ry 321 US 29, 64 S Ct 409, 88 L Ed 520 (1944), stating:

"Courts are not free to reweigh the evidence and set aside the jury verdict merely because the jury could have drawn different inferences or conclusions or because judges feel that other results are more reasonable."

This Court then followed with its decision in Lavender v Kurn 327 US 645, 66 S Ct 740, 90 L Ed 916 (1946), saying:

"Only when there is a complete absence of probity facts to support the conclusion reached does a reversible error appear."

The sum total of these cases have, since that time, been referred to as the Brady rule, that a verdict may properly be directed when, without weighing the credibility of the witnesses, there can be but one reasonable conclusion as to the verdict; but where there is conflicting evidence, or there is insufficient evidence to make only a "one-way" verdict possible, a directed verdict is improper. Moore Federal Practice, Vol 5A, pp 50-25 through 50-27.

(b) U. S. Fifth Circuit Court Of Appeals Standard.

The Fifth Circuit Court Of Appeals had generally applied the Brady rule standard for considering directed verdicts, specifically adopted in Planters Manufacturing Co. v Protection Mut. Ins. Co. (CA 5, 1967) 380 F. 2d 869.

However, in Boeing Company v Shipman 411 F. 2d 365 (CA 5, 1969), the Fifth Circuit overruled Planters and in so doing stated that Planters's test of the sufficiency of evidence to create a jury question failed as a uniform federal standard of general application. Boeing held that the Brady rule as set forth and adopted in Planters was applicable only to Federal Employers' Liability Act (FELA) 45 U.S.C. Section 51 et seq. cases, and to Jones Act 46 U.S.C. Section 688 cases, and was not applicable to diversity and other federal cases.

The Boeing opinion continued:

> "...the (U.S.) Supreme Court has not answered the question of law ...that the FELA test of sufficiency of evidence is applicable in non-FELA cases."

Footnote 10 of Boeing quotes 2B Barron and Holtzoff, Federal Practice And Procedure, Section 1075, pp. 401, 404 (Wright ed. 1961):

> "It is extremely important to know whether the decisions in FELA and Jones Act cases are confined to the particular statutory actions in which they have been handed down."

The Fifth Circuit continues in Boeing:

> "We now determine what the proper test should be in determining whether there is sufficient evidence to submit a case to the jury in connection with motions for directed verdict in a federal court trial. The standard we announce is the result of a thorough study of the numerous prior decisions of this Court which have dealt with the subject. Our task is compounded by the fact that many legal writers and commentators have used different formulations in propounding these standards and the language utilized by them remains diverse and occasionally troublesome."

The Boeing opinion then sets forth the new Fifth Circuit standard for use in determining what it will consider in ruling on the propriety of granting or refusing directed verdicts:

(Fifth Circuit Standard)

"On motions for directed verdict and for judgment notwithstanding the verdict the Court should consider all of the evidence-not just that evidence which supports the non-mover's case-but in the light and with all reasonable inferences most favorable to the party opposed to the motion. If the facts and inferences point so strongly and overwhelmingly in favor of one party that the Court believes that reasonable men could not arrive at a contrary verdict, granting of the motions is proper. On the other hand, if there is substantial evidence opposed to the motions, that is, evidence of such quality and weight that reasonable and fair-minded men in the exercise of impartial judgment might reach different conclusions, the motions should be denied, and the case submitted to the jury. A mere scintilla of evidence is insufficient to present a question for the jury. The motions for directed verdict and judgment n. o. v. should not be decided by which side has the better of the case, nor should they be granted only when there is a complete absence of probative facts to support a jury verdict. There must be a conflict in substantial evidence to create a jury question. However, it is the function of the jury as the traditional finder of the facts, and not the Court, to weigh conflicting evidence and inferences, and determine the credibility of witnesses."

-Boeing v Shipman (supra)

It is very obvious that the standard in Boeing is quite different from that as established in the Brady rule, and this conflict casts every litigant with federal cases in the jurisdiction of the Fifth Circuit into a quagmire with little chance of relief.

In the Boeing opinion, the Fifth Circuit Court Of Appeals did not hesitate to announce that it was recognizing two different standards to be applied in connection with directed verdicts, one being that applicable to FELA and Jones Act cases, this presumably being the U. S. Supreme Court's Brady rule that a verdict may properly be directed only when there can be but one reasonable conclusion as to the verdict; and the Fifth Circuit's own rule as announced in Boeing, which seems to be that there must be a "conflict in substantial evidence to create a jury question."

According to the opinion written by Fifth Circuit Judge Carolyn Randall in the case at bar, her Panel applied the Boeing test, and found that the taxpayers

> "..failed to present substantial evidence...offered no credible evidence to support the jury verdict...(taxpayers' expert

witness CPA) Mr. Alexander's testimony is both legally and factually erroneous."

2. THE DECISION BELOW RAISES SIGNIFICANT AND RECURRING PROBLEMS CONCERNING THE APPROPRIATE STANDARD TO BE APPLIED TO DIRECTED VERDICTS.

The directed verdict is normally used in two overlapping categories of cases. First, where there is a complete absence of pleading or proof on an issue or issues material to the cause of action or defense. This is the situation that historically gave rise to the device of the directed verdict. Second, where there are no controverted issues of fact upon which reasonable men could differ. The reason supporting the first category is obvious, and the question of the total absence of proof quickly merges into the question whether the proof adduced is so insignificant as to be treated as the equivalent of the absence of proof. - Moore's Federal Practice, Vol 5A, pp. 50-20 and 50-24.

What constitutes a "conflict in substantial evidence"? Is it the quality of the evidence, the quantity of the evidence, or both, that makes up "substantial evidence"? No definition has been given.

In the case at bar, expert witness CPA Alexander testified for Petitioners that the Construction company was entitled to a deduction for payroll and asphalt purchases, and that they had not been given the deduction by the IRS in its audit. The IRS Agent testified that he had allowed the deductions in his audit of the Construction company. Is this not a "conflict of substantial evidence"?

Also in the case at bar, the CPA testified for Petitioners that the addition to the Asphalt company's income for credit sales to the Construction company was improper because it had not been carried far enough, and should not have been made. IRS Agent Shelton testified that the adjustment was proper, and that he had carried it far enough. Is this not a "conflict of substantial evidence"?

The Brady rule makes a point of

allowing the jury to determine credibility:

> "without (the Court) weighing the credibility of the witnesses..."

It is fair and reasonable to say that much of the opinion written by Fifth Circuit Judge Carolyn Randall, from beginning to end, is for the most part devoted to an attack on the credibility of Petitioners' expert witness, CPA Wynn Alexander:

> "Mr. Alexander's testimony is both legally and factually erroneous."

> "Therefore, the factual predicate for Mr. Alexander's testimony as to the correctness of Agent Shelton's deductions for 1972 fails."

> "Construction relied on testimony by Mr. Alexander about the theoretical necessity under generally accepted accounting principles for double entries, which was inapposite...."

> "In support of MR. Alexander's novel legal proposition...."

> "Gautier produced no evidence other than legally incorrect assertions of Mr. Alexander in support of the jury verdict ...."

While the Boeing rule does not specifically forbid "weighing the credibility

of the witnesses" in that exact wording, it does recognize the jury's function to "determine the credibility of witnesses." When the Fifth Circuit panel characterized expert witness CPA Alexander's testimony as "both legally and factually erroneous", there is no doubt that they were "weighing the credibility of the witness." It ruled there was no evidence.

In at least three diversity cases, the U. S. Supreme Court has entered per curiam reversals when the U. S. Fifth Circuit has substituted its views of the sufficiency of the evidence for those of the jury. Williams vs Carolina Life Ins. Co. 348 US 802, 75 S Ct 30, 99 L Ed 633; Swafford vs Atlantic Coast Line R. Co. 350 US 807, 76 S Ct 80, 100 L Ed 725; Gibson vs Phillips Petroleum Co. 352 US 874, 77 S Ct 16, 1 L Ed 2d 77.

In writing her panel's opinion in the case at bar, Circuit Judge Carolyn Randall cited Group Life & Health Ins. Co. vs. United States, 660 F. 2d 1042, (CA 5, 1981), cert. denied, ___ US___, 102 S Ct 2958, 73 L. Ed 1349 (1982), which happens to be an income tax refund suit heard on appeal by a Fifth

Circuit panel of which Judge Randall was also a member. The case involved extensive testimony by actuaries and other insurance experts for and on behalf of the taxpayer, who was awarded a sizeable refund by the District Court. However, the Fifth Circuit panel held that the Government's motion for a directed verdict should have been sustained, because there was "no evidence" to support the District Court's decision.

In the case at bar, the Fifth Circuit panel cited Boeing Co. vs Shipman in support of its holding that Judge Walter Nixon Jr. should have granted the Government's motions for directed verdicts during the district court trial. However, Judge Nixon cited Boeing as the basis for his denying the motions:

Judge Nixon: "Applying the principle of Boeing vs Shipman and its progeny, to the effect that on a ruling on a motion to exclude and direct a verdict, the Court must consider all of the evidence of record at the time and if the evidence together with all reasonable inferences to be adduced therefrom would lead fair-minded men in the exercise of fair and impartial judgment to possible different conclusions, that is, if they could differ in that respect, then the motion

should be denied, but on the other hand, if the evidence of record is such that it would permit only one conclusion to be reached, that is, a conclusion in favor of the party by whom the motion is made, then it must be granted. Applying this principle to the evidence before the Court, the Court is of the opinion that the Defendant's motion with respect to all three plaintiffs' cases is without merit and will be denied."

In his lengthy dissent in Boeing Co. vs Shipman, supra, Circuit Judge Rives wrote:

> "..the district courts retain extremely broad discretion to grant new trials. In the early days of the common law, the remedy for a jury finding contrary to the evidence was to grant a new trial. That continues to be the safest remedy, less subject to reversal, and encroaching least on the constitutional fact-finding province of the jury. Moreover, it keeps the decision where it belongs, in the hands of the district judge who has seen and heard the witnesses testify and observed their demeanor on the stand. A more general use of new trial instead of directed verdict would save the appellate judges many precious judicial man hours in these days

> of exploding dockets. Strange to say, however, we do not hear that factor mentioned by appellate court judges when they are reaching out for power to substitute their views for those of the jury." - pp. 390, 391.

The present state of affairs is that the standards and decisions relating to granting a motion for a directed verdict in the U. S. Fifth Circuit Court Of Appeals contradict, negate and substantially overreach the standard and decisions promulgated by the U. S. Supreme Court.

The cases of the Petitioners herein are classic examples of the result.

3. THE DECISION BELOW VIOLATES THE SEVENTH AMENDMENT TO THE U. S. CONSTITUTION

Article III, Section 2 of the Constitution and the Sixth and Seventh Amendments provide for the right of trial by jury. The question of sufficiency of the evidence to require submission of a case to the jury presents constitutional questions, and the U. S. Supreme Court has written on this at length in the leading case of Galloway vs United States 319 US 372, 63 S. Ct 1077, 87 L. Ed 1458 (1943).

It does not necessarily violate the Constitutional right to a trial by jury when a directed verdict is given, if due process of law and equal protection under the law is observed. However, since the right to trial by jury is a Constitutional right, it follows that the test of the sufficiency of evidence must be based upon the Constitution.

The U. S. Court Of Appeals for the Fifth Circuit takes the opposite point of view, expressed in Boeing Co. vs Shipman as follows:

> "...the Seventh Amendment of the United States Constitution providing for a trial by jury does not require, either expressly or impliedly, that the test of sufficiency of evidence to create a jury question in a non-FELA federal case be the same as in an FELA case."
>
> Judge Rives again dissents:
> "I do not agree. My text is that the FELA standard is based upon the Constitution. That proposition is virtually ignored by the majority."
>
> (continuing:)"In other words, the Seventh Amendment protects without any exception whatever, all trials at common law under Federal jurisdiction, as

> established in England and in this country at the date of the adoption of that Amendment."

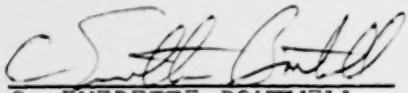
It is applying different standards to the test of the sufficiency of evidence, such as the differences that exist between the U. S. Supreme Court and the Fifth Circuit Court Of Appeals, as alluded to above, as well as having at least two different standards within the Fifth Circuit itself, that violates due process and equal protection under the law, and accordingly that violates the Seventh Amendment right to a jury trial.

Since the processes of the Fifth Circuit worked these different standards in the case at bar, Petitioners' Seventh Amendment rights were also violated.

CONCLUSION

For these reasons, a Writ Of Certiorari should issue to review the judgment and opinion of the U. S. Fifth Circuit Court Of Appeals.

Respectfully submitted,



C. EVERETTE BOUTWELL
P. O. Box 4448
Laurel, Miss. 39440
(601) 649-3221
Counsel For Petitioners

May 27, 1983

APPENDIX

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MALLETTE BROS. CONSTRUCTION CO., INC.,
Plaintiff-Appellee,

v.

UNITED STATES of America,
Defendant-Appellant.

GAUTIER ASPHALT COMPANY, INC.,
Plaintiff-Appellee,

v.

UNITED STATES of America,
Defendant-Appellant.

MALLETTE BROS. TRUCK LINES, INC.,
Plaintiff-Appellee,

v.

UNITED STATES of America,
Defendant-Appellant.

Nos. 81-4374 to 81-4376.

United States Court of Appeals,
Fifth Circuit.

Jan. 14, 1983.

Tax refund suits were consolidated. The United States District Court for the Southern District of Mississippi, Walter L. Nixon, Jr., Chief Judge, entered judgment in favor of taxpayers on all issues, and Government appealed. The Court of Appeals, Randall, Circuit Judge, held that: (1) evidence did not support jury verdicts in favor of taxpayers, and (2) it was error for District Court to submit to jury issue not raised in one taxpayer's claim for refund.

Reversed.

1. Internal Revenue ⇐4528

Where taxpayer's books and records are incomplete or do not accurately reflect income, Internal Revenue Service is authorized to use what ever method it deems appropriate to reconstruct taxpayer's income. 26 U.S.C.A. Sections 446(b), 6001.

2. Internal Revenue ⇐4556

Deficiency notice is accompanied by presumption of correctness which places burden on taxpayer of establishing all matters necessary to show that he does not owe taxes in question.

3. Internal Revenue ⇐5076

Taxpayer seeking refund must demonstrate not only error in asserted deficiency but also amount of refund to which he is entitled, i.e., correct amount of his tax liability.

4. Internal Revenue ⇐5095

In tax refund suits, district court was required to direct verdict in favor of the Government or to enter judgment notwithstanding verdict in its favor if, considering all of evidence in light and with all reasonable inferences favorable to taxpayer, district court concluded that taxpayer failed to present substantial evidence either that the Internal Revenue Service's determination was erroneous or as to correct amount of his tax liability.

5. Internal Revenue ⇐5083

In tax refund suit, taxpayer offered no credible evidence to support jury verdict that taxpayer

was entitled to deduct, as expenses paid or incurred, certain amounts for two tax years and that those deductions had not been allowed by the Government.

6. Internal Revenue ⇐5083

In tax refund suit, record failed to support jury verdict that taxpayer, on its tax return for one year, did not understate its accounts receivable as determined by the Internal Revenue Service so as to entitle it to a refund.

7. Internal Revenue ⇐3560

Income must be reported by, and is taxable to, taxpayer who earns it.

8. Internal Revenue ⇐4980

Taxpayer suits for refunds are governed, in part, by principles of sovereign immunity.

9. United States ⇐125(5)

The United States may be sued only where Congress has expressly provided its statutory consent.

10. Internal Revenue ⇐4980

In suits for tax refunds, the United States has consented to be sued but only when taxpayer follows statutory conditions. 26 U.S.C.A. Section 7422(a).

11. Internal Revenue ⇐5007

Absent waiver by government, taxpayer is barred from raising in refund suit grounds for recovery which had not previously been set forth in its claim for refund; alleged error must be clearly and specifically set forth in refund claim and generalized plea of error will not suffice.

12. Internal Revenue ⇐5007

In tax refund suit, district court erred in submitting to jury taxpayer's claim that certain amounts received by it from a corporation were non-taxable loans where those grounds for recovery had not previously been set forth in claim for refund and Government's did not waive right to object to variance between grounds set forth in claim for refund and those asserted in second supplemental answers to Government's interrogatories and at trial in light of objections by government's counsel at trial, to introduction of loan issue notwithstanding fact that government's counsel discussed loan issue in opening remarks and put on evidence with respect to it.

13. Internal Revenue ⇐5008

In tax refund suit, government may waive requirements of regulations with respect to detailed grounds and facts to be included in claim for refund.

Appeals from the United States District Court for the Southern District of Mississippi.

Before WISDOM, RANDALL AND TATE, Circuit Judges.

RANDALL, Circuit Judge:

These suits for tax refunds essentially involve the tax effect of funds and assets transferred among three related corporations having few financial

records. Following an audit of those records that did exist, the Internal Revenue Service assessed deficiencies against each corporation for its fiscal years ended in 1972 and 1973. The corporations paid the assessments and sued for refunds. Following a trial, the jury rendered verdicts in favor of the corporations on all issues. The Government appeals, contending in the case of two of the corporations that there is no evidence to support the jury verdicts, and in the case of the third corporation that it was error for the district court to submit to the jury an issue not raised in the corporation's claim for a refund. We agree with the Government and reverse the judgments of the district court.

I. FACTS AND DECISION BELOW.

Mallette Bros. Construction Co., Inc., ("Construction") is in the business of building and paving highways, parking lots and parking areas. Gautier Asphalt Company, Inc., ("Gautier") manufacturers asphalt in its own plant. Mallette Bros. Truck Lines, Inc. ("Truck") operates long-haul trucks. The capital stock of each of these corporations is owned in equal shares by Glynn Mallette and his brother, Mosely A. Mallette. All the corporations use the accrual method of accounting; however, each has a different tax year. Construction's tax year ends on January 31; Gautier's ends on June 30; and Truck's ends on February 28.

Early in 1974, the Internal Revenue Service conducted an audit of all three corporations for

their tax years ended in 1972 and 1973. The audit was conducted by Revenue Service Agent William H. Shelton. Testimony at trial indicates that the corporations did not maintain any general ledgers. The records of the corporations reviewed by Agent Shelton included tax returns, invoices, cancelled checks, deposit tickets, bank statements, minute books, stock books, a log book maintained by Construction listing its asphalt purchases, delivery tickets prepared by Gautier listing the respective dates, buyers and quantities of asphalt delivered by Gautier and work papers prepared by Buck Albin, an independent accountant hired by the corporations to prepare all tax returns at issue here other than Construction's tax return for the year ended January 31, 1972. In general, Agent Shelton used the bank deposits method, supplemented with his audit of various records and documents maintained by the corporations, in reconstructing the three corporations' gross taxable income. He relied almost exclusively on his audit of the underlying documents and records in determining what deductions and credits each of the corporations was entitled to claim.

Based on Agent Shelton's audit, the Internal Revenue Service assessed the following deficiencies against the three corporations:

Fiscal Year Ended	Construction	Gautier	Truck
1-31-72	$ 8,461.40		
2-28-72			$ 4,242.67
6-30-72		$ 5,838.74	
1-31-73	24,712.70		
2-28-73			$15,076.43
6-30-73		$11,994.68	

The three corporations paid the deficiencies, together with interest, on July 8, 1974, and filed claims for refunds. After these claims were denied, each of the corporations instituted a separate suit for a refund.

Before trial, Gautier conceded that the Internal Revenue Service's determination as to its tax liability for the year ended June 30, 1973 was correct. Additionally, as a result of net operating loss carrybacks, the Internal Revenue Service issued a refund for a portion ($4,216.89) of Truck's tax liability for the year ended February 28, 1973, (leaving only $10,859.54, plus interest, remaining in issue at the trial), and a complete refund of Truck's tax liability for the year ended February 28, 1972. Accordingly, these amounts are not an issue here.

The district court ordered that the separate cases brought by the corporations be consolidated for all purposes. Subsequently, the case was tried to a jury on special interrogatories. During the trial, the Government moved for a directed verdict

following the presentation of the corporations' case and again following the presentation of the Government's case. The court denied both of these motions. The jury decided each of the issues presented to it adversely to the Government. Initially, with respect to Construction, the jury found that for the year ended January 31, 1972, the "plaintiff [Construction was] entitled to deduct, as expenses paid or incurred, the amount of $21,977.26, and that this deduction was not allowed by the Government." As to Construction's year ended January 31, 1973, the jury found that Construction was "entitled to deduct, as expenses paid or incurred, the amount of $93,326.79 and that this deduction was not allowed by the Government." As to Gautier's year ended June 30, 1972, the jury found that Gautier did not "understate its accounts receivable by $37,687.32, as determined by the Internal Revenue Service." Finally, as to Truck's year ended February 28, 1973, the jury found that Truck "in its federal income tax return ... [did not] understate its gross income by $39,994.62, as determined by the Internal Revenue Service. . . ." The district court subsequently entered judgments on the jury verdict reflecting the jury's findings.

On April 27, 1981, the Government filed motions requesting judgments notwithstanding the verdict. Primarily, the Government argued in each of these motions that its "motion for directed verdict should have been granted because the plaintiff's evidence, including all reasonable inferences which may be

drawn therefrom, considered in its most favorable light to the plaintiff, does not establish" that the deficiency assessed by the Internal Revenue Service was in any way erroneous. As to Truck, the Government renewed an objection made at trial that there had been a fatal variance between Truck's claim for a refund and the claims presented by Truck at trial concerning alleged loans from Construction to Truck. Additionally, the Government noted that the district court had entered a judgment holding that the Government's adjustments had resulted in an overstatement in Truck's gross income of $39,994.62 when Truck had not even challenged that determination except insofar as the judgment exceeded $11,794.62. Following a hearing, the district court entered orders denying the Government's motions. This appeal followed.

II. PROPRIETY OF A JUDGMENT NOV AS TO CONSTRUCTION AND GAUTIER.

On appeal, the Government urges that the district court erred in not entering a directed verdict or a judgment notwithstanding the verdict in favor of the Government as to each of Construction and Gautier. Specifically, the Government argues that there was no evidence to support the jury's determination that Construction was entitled to deduct, as expenses paid or incurred, the amounts of $21,977.26 for 1972 and $93,326.79 for 1973, and that these deductions had not been allowed by the Government. As to Gautier, the Government argues that there was no evidence to support the jury's determination that Gautier had not understated its

accounts receivable (and its gross income) for 1972 by $37,687.32.

[1-3] Before we review the evidence, it would be useful to set forth the taxpayers' burden in these cases and the standard of appellate review. Every taxpayer must maintain accounting records which enable him to file a correct tax return. I.R.C. Section 6001; Treas.Reg. Section 1.446-1. Where a taxpayer's books do not accurately reflect income, the Internal Revenue Service is authorized to use whatever method it deems appropriate to reconstruct the taxpayer's income. I.R.C. Section 446(b); Webb v. Commissioner, 394 F.2d 366, 371-72 (5th Cir.1968); See also United States v. Firtel, 446 F.2d 1005, 1006-07 (5th Cir.1971). Any ensuing deficiency notice is accompanied by a presumption of correctness which places the burden on the taxpayer of establishing all matters necessary to show that it does not owe the taxes in question. Southwestern Life Insurance Co. v. United States, 560 F.2d 627, 635 (5th Cir. 1977), cert. denied, 435 U.S. 995, 98 S.Ct. 1647, 56 L.Ed.2d 84 (1978) (citing Helvering v. Taylor, 293 U.S. 507, 55 S.Ct. 287, 79 L.Ed. 623 (1935)); Webb, supra, 394, F.2d at 372. A taxpayer seeking a refund must demonstrate not only the error in the asserted deficiency but also the amount of the refund to which he is entitled, i.e., the correct amount of his tax liability. United States v. Janis, 428 U.S. 433, 440, 96 S.Ct. 3021, 3025, 49 L.Ed.2d 1046 (1976); Griffin v. United States, 588 F.2d 521, 530 (5th Cir.1979).

[4] The district court is required to direct a verdict in favor of the Government or to enter a judgment notwithstanding the verdict in its favor if, considering all of the evidence in the light and with all reasonable inferences favorable to the taxpayer, the district court concludes that the taxpayer has failed to present substantial evidence either that the Internal Revenue Service's determination is erroneous or as to the correct amount of his tax liability. Group Life & Health Insurance Co. v. United States, 660 F.2d 1042, 1050-51 (5th Cir.1981), cert. denied, ___ U.S.___, 102 S.Ct. 2958, 73 L.Ed.2d 1349 (1982); Boeing Co. v. Shipman, 411 F.2d 365, 374-75 (5th Cir.1969).

A. Construction.

Turning first to the jury's verdict that Construction was entitled to deduct, as expenses paid or incurred, the amounts of $21,977.26 for 1972 and $93,326.79 for 1973, and that these deductions had not been allowed by the Government, we begin by noting that Construction conceded during the trial that Agent Shelton had properly determined its gross income for 1972 and 1973 and further that Agent Shelton had not improperly denied any of its claimed deductions. Instead, Construction's position at trial was that for each dollar of additional gross income discovered by Agent Shelton, it was entitled to an additional payroll deduction or an additional expense deduction for asphalt purchased. Allegedly, these deductions had not previously been claimed by Construction, nor had they been allowed by Agent Shelton.

Construction's position was that deductible expenses for asphalt and payroll were understated by approximately the same amount as was gross income and, consequently, that the taxable income reported on its original return was basically correct.

Four witnesses testified at the trial, two for the corporations and two for the Government. The two witnesses for the corporations were Glynn Mallette, Secretary-Treasurer and a 50% stockholder of each of the corporations, and Winn Alexander, a certified public accountant from Wiggins, Mississippi, who testified as an expert in accounting, auditing and taxation matters. The principal Government witness was Agent Shelton. Agent Shelton testified that in conducting his audit, he had discovered that the books and records maintained by the three corporations did not accurately reflect their income. As noted, none of the corporations maintained general ledgers. The work papers that did exist contained discrepancies and omissions. To determine each corporation's gross income, therefore, Agent Shelton initially analyzed the deposit tickets and bank statements for the two bank accounts (a general account and a payroll account) maintained by each corporation. Agent Shelton then subtracted from the total amount deposited to the accounts of each corporation amounts received which were nontaxable, such as loans, insurance checks, transfers between accounts maintained by the same corporation and amounts received as adjustments for prior purchases. Since each of the corporations used the accrual method of accounting, Agent Shelton then

added income accrued but not yet received.

After determining each corporation's gross income, Agent Shelton proceeded to determine the deductions (including expenses accrued, but not yet paid) that the corporation was entitled to claim. That determination was made primarily by examining the underlying documents--invoices, checks, Gautier's delivery receipts and Construction's log books. Turning to the specific expense items at issue here for Construction--asphalt purchases and payroll expenses--Agent Shelton testified that in order to determine the amount of asphalt purchased by Construction each month for each of the years in question (1972 and 1973), he used the delivery receipts prepared by Gautier and Construction's log of purchases to make a schedule listing the cost of asphalt purchased each month. Similarly, in determining the appropriate payroll expense deductions for Construction, Agent Shelton used the actual checks and the bank statements from the payroll account maintained by Construction.

No testimony was ever offered by Construction suggesting that Agent Shelton's schedule of asphalt purchases was erroneous--that he had failed to include all of the transactions disclosed by the delivery receipts and log or that the delivery receipts and log were incomplete. Glynn Mallette, one of Construction's two witnesses, testified on cross-examination by the Government that the total amount of asphalt purchased by Construction from Gautier, and its cost, could properly be determined from the

log maintained by Construction. Mr. Alexander, the other witness for Construction, testified that although he believed, for the reasons addressed below, that Construction was entitled to additional deductions for asphalt purchased, he did not know how much asphalt Construction had actually purchased during the years in question. Insofar as payroll expense is concerned, except for the theory addressed below, no witness for Construction offered any testimony questioning Agent Shelton's calculations or the records he relied on. Mr. Mallette testified generally that he could not "point out any error" in plaintiffs' exhibit 8, which was the income tax audit changes (Form 4549) prepared by Agent Shelton. Mr. Alexander's testimony did not specifically address Construction's payroll expense. In summary, the only testimony which specifically addressed specifically actual expenses paid or incurred by Construction for asphalt and payroll for 1972 and 1973 was that of Agent Shelton.

Instead of presenting specific testimony, Construction contended, through the testimony of Mr. Alexander, that Agent Shelton had erred in not using the double entry system of accounting in adjusting its tax liability. Mr. Alexander's testimony is both legally and factually erroneous. Factually, the argument appears to be based on the premise that Agent Shelton had arrived at each corporation's tax liability for 1972 and 1973 simply by making adjustments to the work papers prepared by Mr. Albin, the certified public accountant who prepared the

corporation's tax returns. Since those work papers were prepared on a double entry basis and were in balance, the corporations argued that, in the case of Construction, the concededly correct increase by Agent Shelton in the gross income of Construction should, as a theoretical matter, have been accompanied by offsetting deductions for payroll and asphalt purchase expense, lest the corporation's accounts somehow become out of balance. No reason was given by Mr. Alexander as to why those expense accounts were selected rather than others, and no testimony was given as to specific amounts omitted from those accounts.

As an initial matter, we note that Mr. Albin did not prepare Construction's 1972 tax return and there is no evidence in the record of this case that a double entry set of records existed for that year. Therefore, the factual predicate for Mr. Alexander's testimony as to the correctness of Agent Shelton's deductions for 1972 fails. As to 1973, Agent Shelton's testimony makes it amply clear that he did not arrive at his figures for the taxable income of the corporations for the years involved simply by making adjustments to Mr. Albin's work papers. He testified that those work papers contained too many inaccuracies and omissions to be used for that purpose. Rather, as explained above, using the underlying documents, he prepared his own work papers. For this reason, Construction's challenge to the deficiency assessment, which is based on a factual predicate as to the source of that assessment finding

no support in, and in fact directly contradicted by, the record, must fail.

One of the legal bases for Mr. Alexander's testimony was arguably abandoned by the corporations' counsel at trial, but it may have resurfaced in their appellate briefs and will be briefly addressed. Mr. Alexander testified repeatedly in his direct examination that as a theoretical matter, if the Government, upon audit, increases the taxpayer's gross income, it must also increase deductible expenses by an equal amount. E.g., "If they were going to add it to income, they should have treated it as a deduction." On cross examination, however, Mr. Alexander conceded that there are instances in which the Internal Revenue Service can properly find unreported income without allowing offsetting and equal deduction. We need say no more than that, as a matter of law, Mr. Alexander was correct on cross examination, and his statements on direct examination cannot be used as a basis for supporting the jury verdict.

Although Mr. Alexander's testimony at trial and the corporations' appellate briefs are somewhat unclear at this point, they may be making a related argument that there is some sort of legal requirement that the Government use the double-entry method of accounting simultaneously to reflect items of income and expense when it reconstructs a taxpayer's taxable income on audit. But, as the Governmental correctly points out, the bank deposits method, as used and supplemented by Agent Shelton in this case, is not

a method of accounting--as distinguished from the double entry system of accounting--but is, instead, an audit procedure used by the Government to establish a taxpayer's correct taxable income. See Snyder v. Commissioner, 28 T.C.M. (CCH) 856, 866 (1969) ("[The bank deposits and expenditures method] is not a system of accounting; it is not a substitute for either the cash or accrual basis of accounting or any other recognized method of keeping books. When correctly applied to the facts of a particular situation it is merely evidence of income.") (citing Holland v. United States, 348 U.S. 121, 75 S.Ct. 127, 99 L.Ed. 150 (1954) (to the same effect, dealing with the net worth method)). Because the Government's only objective, in employing the bank deposits method, as supplemented by Agent Shelton in this case, is to reconstruct taxable income, the Government is concerned only with transactions entered into during the relevant periods that affected taxable gross income or deductible expenses. It was, therefore, unnecessary for Agent Shelton to record every transaction on a double entry basis in the manner which would be required for an accounting of the transaction in accordance with generally accepted accounting principles. If Construction was of the view that the deficiency assessments for 1972 and 1973 resulting from Agent Shelton's auditing procedures were inaccurate because items of deductible expense paid or incurred by Construction had not been taken into account, then it was incumbent upon it to offer specific proof of those items and of the fact that

they had not been allowed. No such specific proof was offered by Construction. Instead, Construction chose to rely on testimony by Mr. Alexander about the theoretical necessity under generally accepted accounting principles for double entries, which was inapposite, and the theoretical necessity under the audit method employed here for deductions to offset the concededly proper increase in Construction's gross income, which is legally incorrect.

[5] In summary, we agree with the Government that Construction offered no credible evidence to support the jury's verdict that Construction was entitled to deduct, as expenses paid or incurred, the amounts of $21,977.26 for 1972 and $93,326.79 for 1973, and that these deductions had not been allowed by the Government. The district court erred in not granting a judgment notwithstanding the verict in favor of the Government as to that portion of the jury verdict.

B. Gautier.

[6] The jury's verdict that Gautier, on its tax return for 1972, did not "understate its accounts receivable by $37,687.32, as determined by the Internal Revenue Service" also finds no support in the record.

During the course of his audit, Agent Shelton determined that the amount of gross income reported on Gautier's income tax return for 1972 had been understated by $38,662.40. The principal component of this adjustment was $37,687.32 in income Gautier

had accrued from sales of asphalt to Construction for which no payment had been made as of June 30, 1972, the close of Gautier's taxable year.

In arriving at the $37,687.32 figure, Agent Shelton testified that he used the same schedule (plaintiffs' exhibit 8(A)) that he had used to determine Construction's expenses for asphalt purchased from Gautier. This schedule listed both the total amount of asphalt purchased by Construction from Gautier (as credits) and the total amount of money transferred by Construction to Gautier during each month (as debits). The column entitled "Balance" represented the amount of money Construction owed to Gautier for asphalt received by Construction, but not yet paid for. Because Gautier's tax year ended on June 30, Agent Shelton determined that Gautier was obligated to report in its return for 1972 the amount of income accrued, but not yet paid, as of June 30, 1972, or $37,687.32. Finally, Agent Shelton testified that this $37,687.32 was also included in the $158,385.00 allowed Construction as a deduction for asphalt purchased from Gautier during its fiscal year ended January 31, 1973.

The only evidence produced on Gautier's behalf was Mr. Alexander's testimony. He testified that the $37,687.32 was indeed "[f]or asphalt that the construction company still owed the asphalt company for." Mr. Alexander also admitted that if the figures in exhibit 8(A) were correct, the $37,687.32 figure was also correct. He contended, however, that because Agent Shelton had failed to make a

separate entry on Construction's books reflecting this expense, the adjustment to Gautier's income was improper. This theory sounds somewhat like the theory with respect to double entry accounting (or auditing) advanced by Mr. Alexander with respect to Construction, except that in this case, the alleged impropriety related to a supposed failure of Agent Shelton to allow a related company (Construction), as distinguished from the taxpayer (Gautier), a separate, corresponding deduction in an amount equal to the amount of the taxpayer's unreported gross income.

[7] As a legal matter, it is irrelevant whether Construction actually received a deduction for the amount of income unreported by Gautier. Construction and Gautier are separate taxable entities. Income must be reported by, and is taxable to, the taxpayer who earns it. E.g., Helvering v. Eubank, 311 U.S. 122, 124-25, 61 S.Ct. 149, 150-51, 85 L.Ed. 81 (1940); Helvering v. Horst, 311 U.S. 112, 115-20, 61 S.Ct. 144, 146-49, 85 L.Ed. 75 (1940); Lucas v. Earl, 281 U.S. 111, 114-15, 50 S.Ct. 241, 75 L.Ed. 731 (1930).

In support of Mr. Alexander's novel legal proposition, Gautier cites only two sources--Lustman v. Commissioner, 322 F.2d 253 (3rd Cir.1963), and Treas. Reg. Section 1.1312-6(a). In Lustman v. Commissioner, the Court of Appeals for the Third Circuit affirmed the trial Court's determination that the taxpayer had failed to present sufficient evidence demonstrating that it was entitled to certain deductions the

taxpayer had claimed. One of the factors noted by the Court of Appeals in reaching this result was that a related corporation had failed to include these items in its gross income. Lustman, supra, at 256-58. We agree with the Government, however that the case hardly stands for the proposition that one entity may exclude amounts of admitted income if another corporation does not claim a corresponding deduction.

Treas. Reg. Section 1.1312-6(a) provides that where a determination is made either allowing or disallowing a deduction or a credit as to one corporation, and as a result a "correlative deduction or credit [is] erroneously allowed, omitted, or disallowed in respect" to an affiliated corporation, even though the correction of the second error is normally barred by the statute of limitations, it will be taken into account in determining the correct tax liability of the first corporation. Once again, we agree with the Government that this position does not support the proposition that Gautier is entitled to either an exclusion or a deduction from its gross income to reflect an expense incurred but allegedly not deducted by Construction.

Finally, the only evidence in the record as to whether Construction was, in fact, allowed a deduction for the amount added to Gautier's income consisted of the testimony of Agent Shelton referred to above. He explained that the $37,687.32 figure cannot be separately found in his calculations because it was a part of the $158,385 figure

Construction was allowed for purchases of asphalt for its year ended January 31, 1973 (the $37,687.32 figure being for Gautier's year ended June 30, 1972). Agent Shelton testified that both figures came from the same schedule.

In summary, Gautier produced no evidence other than legally incorrect assertions of Mr. Alexander in support of the jury verdict that Gautier, on its tax return from 1972, did not understate its accounts receivable by $37,687.32, as determined by the Internal Revenue Service. The district court was in error in refusing to grant a judgment notwithstanding the verdict in favor of Gautier on this point.

III. THE VARIANCE BETWEEN TRUCK'S REFUND CLAIM AND THE ISSUE AS TO THE LOANS TO TRUCK SUBMITTED TO THE JURY.

Upon completion of Agent Shelton's audit, Truck received a notice of deficiency and copies of the audit reports prepared by Agent Shelton. After paying the tax liability, Truck filed a claim for refund. As relevant here, Truck alleged the following in its claim for refund:

> The taxpayer should be permitted to exclude the $39,995 from gross income as it consists of inter-company adjustments for which no corresponding deduction has been allowed in two affiliated companies; if intercompany accounts were to be set up, to be proper, they should have been reconciled & balanced in detail between the 3 affiliates.
>
> ....

The taxpayer should be allowed to exclude from its gross income any income also included in the income of its two affiliated corporations, and/or to take a deduction for any intercompany adjustment properly considered as an adjustment to income of the two affiliates, which such item would accordingly be a deduction to one or both of the affiliates.

In its complaint, Truck simply incorporated the various allegations contained in its claim for refund. In addition, Truck alleged that "[t]he assessment and collection of the deficiency plus interest was erroneous and illegal."

During discovery, the Government, by interrogatory, requested, with respect to the above assertions, answers to the following questions:

> [4.] With respect to such allegations, (a) state the facts upon which such allegations are based, ... and (e) state specifically (1) whether the $39,995 constituted gross income to the plaintiff for its fiscal year ended February 28, 1973, (2) whether the $39,995 was reported as income in the plaintiff's federal income tax return for the fiscal year ended February 28, 1973, (3) the heading under which the $39,995 was reported in the plaintiff's federal income tax return for the fiscal year ended February 28, 1973, (4) the names of the "two affiliated companies" referred to, (5) the facts which indicate that the companies referred to are "two affiliated companies," (6) the facts which indicate that a corresponding deduction

should have been allowed in "two affiliated companies," (7) the amount of the $39,995 which should have been allowed as a deduction to each of the two affiliated companies, (8) whether the "two affiliated companies" reported the $39,995 in their federal income tax returns, (9) the amount of the $39,995 which each of the "two affiliated companies" reported in their federal income tax returns, respectively, and (10) the facts which indicate that each such amount was properly reported in such returns, respectively.

Truck's response was as follows:

4. (a) Purchases and sales between the Plaintiff and its two (2) affiliates had already been accounted for and set up in inter-company payables and receivables, and the additional $49,995 was not owed. In any event, if the additional $39,995 was to be added to the plaintiff's income, it should have been picked up on the books of one or more affiliates as a deduction.

....

(e)(1) No.

(2) No.

(3) N/A

(4) Mallette Bros. Construction Co., Inc.
Gautier Asphalt Company, Inc.

(5) Glynn Mallette and Moseley A. Mallette each own 50% of the capital stock of the three (3) corporations.

(6) The $39,995 is a part of the $45,660 shown by the IRS as "A/R Asphalt", erroneously

indicating that the Gautier Asphalt Company, Inc. was indebted to the plaintiff for that amount. In the alternative, the Asphalt Company should have been allowed a deduction on its books by the IRS for the corresponding amount of $39,995, thereby reducing its income.

(7) $39,995 to Gautier Asphalt Company, Inc.

(8) No.

(9) None.

(10) Work papers prepared in connection with the preparation of the Federal Income Tax Return showed that inter-company accruals had already been made.

At the pre-trial conference, Truck simply repeated the above contentions. Thus, in the pre-trial order, Truck stated under its claim of ultimate facts that "[b]ecause of these adjustments the income of the plaintiff [Truck] is overstated by the amounts thereof, and the plaintiff brings this action to recover income taxes and interest that resulted from this ... $15,076 [$10,859 after the net operating loss carrybacks] for 1973."

One week before the trial, Truck's counsel called Jack D. Warren, the attorney representing the Government in the trial court, and informed him for the first time that he intended to argue that the increase in gross income determined by Agent Shelton was erroneous because the $39,994.62 adjustment consisted of loans received from Construction. Subsequently, on March 9, 1981, the day the trial commenced, Truck served its second supplemental

answer to the interrogatories, which provided as follows:

> 4. (e)(6) The answer is amended to the following: $28,200,00 [sic] of the $39,995 adjustment consisted of loans received from the Mallette Bros. Construction Co., Inc. that were erroneously included in the income of the Truck line company. The $28,200 in loans should have been deducted from gross income on the Truck Line's return, in as much as the loans did not represent taxable income to the Truck Line Corporation.

During the trial, Mr. Mallette testified that eleven checks totaling $39,200 represented loans from Construction to Truck. The Government objected on the ground that the allegation was not set forth in the claim for refund or in the pleadings. Mr. Warren argued that it was unfair to allow Truck to raise this issue at such a late hour--long after discovery had been completed. Truck's counsel argued that the omission in the interrogatories was "a typographical error or something." Truck also claimed that the "innercompany [sic] adjustment" language in the claim for refund included the loan argument.

The district court overruled the Government's objection, finding that "it is apparent that there was a typographical error ... in the answers to interrogatories that were given by the plaintiff because it is apparent that the plaintiffs are contending that these were loans, or at least innercompany [sic] adjustments ...." In addition, the court

noted that Mr. Warren addressed the loan argument in his opening statement. The court did not address the variance with the claim for refund, although that issue was clearly raised by Mr. Warren's objection.

When requested to state for the record where specifically in the answers to the interrogatories the typographical error occurred, Truck's counsel stated that it was in question 4(e)(6) (set forth above) of the original set of answers. He further stated that the response "was meant to be the same thing as the first response for the first year which is identical to the problem and an identical thing. We said that these were loans--the exact wording: 'This consisted of loans from affiliate, Mallette Bros. Construction Company, Inc.'"

[8-10] Taxpayer suits for refunds are governed, in part, by the principles of sovereign immunity. The United States may be sued only where Congress has expressly provided its statutory consent. See United States v. Mitchell, 445 U.S. 535, 538, 100 S.Ct. 1349, 1351-52, 63 L.Ed.2d 607 (1980); United States v. Testan, 424 U.S. 392, 399, 96 S.Ct. 948, 953, 47 L.Ed.2d 114 (1976); United States v. Sherwood, 312 U.S. 584, 586-88, 61 S.Ct. 767, 769-70, 85 L.Ed. 1058 (1941). In suits for tax refunds, the United States has consented to be sued, but only when the taxpayer follows the conditions set forth in I.R.C. Section 7422(a). That section provides that "[n]o suit [for refund] ... shall be maintained in any court ... until a claim for refund or credit has

been duly filed with the Secretary or his delegate, according to the provisions of law in that regard, and the regulations of the Secretary or his delegate established in pursuance thereof." Treas.Reg. Section 301.6402-2(b)(1) provides, in pertinent part, as follows:

> (b) Grounds set forth in claim. (1) No refund or credit will be allowed ... except upon one or more of the grounds set forth in a claim [properly] filed .... The claim must set forth in detail each ground upon which a credit or refund is claimed and the facts sufficient to apprise the Commissioner of the exact basis thereof ....

[11] Absent a waiver by the Government, a taxpayer is barred from raising in a refund suit grounds for recovery which had not previously been set forth in its claim for a refund. See Angelus Milling Co. v. Commissioner, 325 U.S. 293, 295-99, 65 S.Ct. 1162, 1163-65, 89 L.Ed. 1619 (1945); United States v. Felt & Tarrant Manufacturing Co., 283, U.S. 269, 272-73, 51 S.Ct. 376, 377-78, 75 L.Ed. 1025 (1931); Group Life & Health Insurance Co. v. United States, supra, 660 F.2d at 1058-59; Southwestern Life Insurance Co. v. United States, supra, 560 F.2d at 630-32. The alleged error must be clearly and specifically set forth in the refund claim. A generalized plea of error will not suffice. See Angelus Milling Co. v. Commissioner, supra, 325 U.S. at 296-97, 65 S.Ct. at 1164-65; United States v. Felt & Tarrant Manufacturing Co., supra, 283 U.S. at 272, 51 S.Ct. at 377; Stoller v. United States, 444 F.2d 1391, 1393

(5th Cir.1971). As this court stated in Alabama By-Products Corp. v. Patterson, 258 F.2d 892, 900 (5th Cir.1958), cert. denied, 358 U.S. 930, 79 S.Ct. 318, 3 L.Ed.2d 303 (1959):

> All grounds upon which a taxpayer relies must be stated in the original claim for refund so as to apprise the Commissioner of what to look into; the Commissioner can take the claim at its face value and examine only those points to which his attention is necessarily directed. United States v. Garbutt Oil Co., 1938, 302 U.S. 528, 58 S.Ct. 320, 82 L.Ed. 405. Anything not raised at that time cannot be raised later in a suit for refund. Carmack v. Scofield, 5 Cir., 1953, 201 F.2d 360, 362.

One purpose of these rules is to assure that the Commissioner is apprised of the exact nature of the claim and the facts upon which the claim is advanced so that there is an opportunity to make an administrative determination of the claim. United States v. Felt & Tarrant Manufacturing Co., supra, 283 U.S. at 272, 51 S.Ct. at 377; Stoller v. United States, supra, 444 F.2d at 1393. Another purpose is "to limit the litigation to the issues which have been re-examined by the Commissioner and which he is prepared to defend." Carmack v. Scofield, 201 F.2d 360, 362 (5th Cir.1953).

[12] In this case, Truck's claim for refund cannot be read to raise the loan issue, and we do not understand the district court to have concluded otherwise or, for that matter, even to have addressed

the issue. Truck's contention that the "intercompany adjustments" language raised this issue is not supported by a fair reading of the claim for refund. Each time that phrase was used, it was used in conjunction with the assertion that a corresponding deduction should have been allowed to one of the other affiliated corporations. That very fact necessarily negates Truck's argument that what was being asserted as a ground for error was the existence of loans to Truck (which are not deductible to the lender). Thus, even if the Commissioner were compelled to hazard a guess as to the nature of Truck's claim for refund (which he clearly is not), the refund claim would actually have sent him in the wrong direction.

Truck argues that the scope of the Government's examination was such that the Government was prepared to defend Truck's claim that the intercompany transfers constituted loans. But the Supreme Court made clear in Angelus Milling that the fact that the Commissioner has investigated the underlying facts relating to the claim will not suffice in the absence of a showing that the Commissioner understood the specific claim that was made. Angelus Milling, supra, 325 U.S. at 296-97, 65 S.Ct. at 1164-65.

Turning to the question of Truck's answers to the interrogatories, the district court found that a typographical error was made by Truck in response to question 4(e)(6). We agree with the Government that it is difficult to understand how Truck can contend that the omission of the phrase "[t]his consisted of loans from affiliate, Mallette Bros.

Construction Company, Inc." was a typographical error where no such assertion was made in the claim for refund, the complaint, the first supplemental answers to the Government's interrogatories or the pretrial order. Furthermore, the response to question 4(e)(6) referred to Gautier, not Construction. But apart from the accuracy of the district court's finding as to the existence of a typographical error, we note that the finding that a typographical error occurred does not even address the question whether the Government was on notice of the nature of the claim. Typographical errors (in the form of omissions) may well fall into two categories--those in which the omitted material might fairly have been understood by the reader in spite of the error, and those in which the omitted material could not be understood from a reading of the document. Clearly, whether the omission in this case was the result of a typographical error or not, the omitted material could not be fairly ascertained from the contents of the responses to interrogatories.

[13] The district court seems to have believed that the Government had waived the right to object to the variance between the grounds set forth in Truck's claim for refund and those asserted in its second supplemental answers to the Government's interrogatories and at trial. It is clear that the Government may waive the requirements of the regulations with respect to the detailed grounds and facts to be included in a claim for refund. See United States v. Memphis Cotton Oil Co., 288 U.S. 62, 69-

73, 53 S.Ct. 278, 281-82, 77 L.Ed. 619 (1933). It is equally clear that a taxpayer asserting a waiver bears an extremely heavy burden of proving such a waiver. As the Supreme Court said in Angelus Milling, supra, 325 U.S. at 297-98, 65 S.Ct. at 1164-65:

> Since, however, the tight net which the Treasury Regulations fashion is for the protection of the revenue, courts should not unduly help disobedient refund claimants to slip through it. The showing should be unmistakable that the Commissioner has in fact seen fit to dispense with his formal requirements and to examine the merits of the claim. It is not enough that in some roundabout way the facts supporting the claim may have reached him. The Commissioner's attention should have been focused on the merits of the particular dispute. The evidence should be clear that the Commissioner understood the specific claim that was made even though there was a departure from form in its submission.

Accord, Group Life & Health Insurance Co. v. United States, supra, 660 F.2d at 1058-59; Salyersville National Bank v. United States, 613 F.2d 650, 651-52 (6th Cir.1980); Southwestern Life Insurance Co. v. United States, supra, 560 F.2d at 630-32.

First, we note that the Government counsel at trial clearly and unequivocally asserted his objections to the introduction of the loan issue, and there can be no argument made in this case that the Government failed to object. The fact that Government counsel discussed the loan issue in his opening

remarks and put on evidence with respect to it simply cannot be considered to have constituted a waiver of the Government's right to insist that the claim for refund set forth all the grounds for refund. We agree with the Government that if such a rule were to be established, trial attorneys for the Government would have a Hobson's choice. They would have to either stand on the variance (and thus possibly lose the issue on the merits at the trial level) and then appeal on the variance question, possibly requiring another trial, or abandon the variance argument in the hopes of prevailing on the merits, thereby obviating the necessity of an appeal and another trial.

The prejudice to the Government that occurred when Mr. Mallette was permitted to testify that eleven checks totalling $39,200 constituted loans from Construction to Truck is apparent. Agent Shelton testified that during his audit, he had treated all but $11,000 of the $39,200 at issue as "income to the truck lines" because "they were written off as expenses by the Construction Company." When asked by the court whether he was able to ascertain for what purposes the checks were given, Agent Shelton testified that he was able to ascertain that they were made in payment for hauling by, and purchases of diesel fuel from, Truck. If the checks in fact represented loans, and that fact had been timely disclosed, the Government could have used this fact as an additional reason for denying, at least in part, the claim of Construction. Further,

if the issue had been raised in the claim for refund, the Government might have been able to make an additional assessment against Construction reflecting the additional taxes due because of improper deductions. In allowing Mr. Mallette to testify concerning these loans, the district court opened the door to the possibility of a windfall to Construction in which Construction would have been allowed a deduction for $28,200, to which it might not have been entitled, and at the same time Truck would have been allowed to exclude from income the same $28,200.

In summary, we find that the district court erred in submitting to the jury Truck's claim that certain amounts received by it from Construction were nontaxable loans.

REVERSED.

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 81-4374 - 81-4376

MALLETTE BROS. CONSTRUCTION CO., INC., Plaintiff-Appellee,

versus

UNITED STATES OF AMERICA, Defendant-Appellant.

GAUTIER ASPHALT COMPANY, INC., Plaintiff-Appellee,

versus

UNITED STATES OF AMERICA, Defendant-Appellant.

MALLETTE BROS. TRUCK LINE, INC., Plaintiff-Appellee,

versus

UNITED STATES OF AMERICA, Defendant-Appellant.

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Appeal from the United States District Court for the Southern District of Mississippi

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ON SUGGESTION FOR REHEARING EN BANC

(Opinion JANUARY 14, 5 Cir., 1983, ___F.2d___).

(MARCH 2, 1983)

Before WISDOM, RANDALL and TATE, Circuit Judges.

PER CURIAM:

(X) Treating the suggestion for rehearing en banc as a petition for panel rehearing, it is ordered that the petition for panel rehearing is DENIED. No member of the panel nor Judge in regular active service of this Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 16), the suggestion for Rehearing En Banc is DENIED.

( ) Treating the suggestion for rehearing en banc as a petition for panel rehearing, the petition for panel rehearing is DENIED. The judges in regular active service of this Court having been polled at the request of one of said judges and a majority of said judges not having voted in favor of it (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 16), the suggestion for Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

/s/ Carolyn Dineen Randall
United States Circuit Judge

Office-Supreme Court, U.S.
FILED
OCT 6 1983
ALEXANDER L. STEVAS,
CLERK

No. 83-35

In the Supreme Court of the United States

OCTOBER TERM, 1983

MALLETTE BROS. CONSTRUCTION COMPANY, ET AL.,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

In this consolidated action seeking refunds of federal income taxes, petitioners seek review of the decision below reversing three judgments on jury verdicts that were entered in favor of the petitioners by the United States District Court for the Southern District of Mississippi (Pet. App. A1-A15).[1] The court of appeals found that there was no competent evidence to support the verdicts (Pet. App. A4-A10).

The pertinent facts may be summarized as follows: This case involves the income tax liabilities of three related corporations—Mallette Brothers Construction Company ("Construction"), Gautier Asphalt Company ("Gautier"), and Mallette Brothers Truck Lines ("Truck") (Pet. App.

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[1]The opinion of the court of appeals (Pet. App. A1-A15) is reported at 695 F.2d 145.

A2-A3). The Internal Revenue Service ("IRS") conducted an examination of all three corporations for their fiscal years ending in 1972 and 1973 (Pet. App. A3). In the course of this examination, the IRS agent found that he could not verify the specific items on the corporations' tax returns from the corporate records (Pet. App. A3; see also II R. 200, 205-209, 213-214, 221-228, 231-232). The agent, therefore, reconstructed each corporation's net taxable income. This reconstruction essentially showed that Construction had diverted some of its income to Gautier and that Gautier had failed to report income from sales of asphalt to Construction (Pet. App. A3-A4).

Based on this audit, the IRS asserted deficiencies against petitioners. Petitioners paid the deficiencies and initiated these actions after their timely filed claims for refunds were denied (Pet. App. A-2).

At the trial, two witnesses testified on behalf of the three corporations (Pet. App. A5). Glynn Mallette testified that he was unable to point out any errors in the agent's examination upon which the deficiencies were based (Pet. App. A6; II R. 61-64). Wynn Alexander testified that it was permissible for one corporation (Construction) to fail to report income earned by it but diverted to a related corporation (Gautier), if the amount diverted was included in the related corporation's gross income. As the court of appeals recognized (Pet. App. A9), however, this position is contrary to the established principle of tax law that income is taxed to the entity that earns it. See *Lucas* v. *Earl*, 281 U.S. 111, 114-115 (1930).

Alternatively, Construction argued that, although it was proper for the Commissioner to adjust its gross income to include the diverted funds, a corresponding entry should have been made to Construction's expense accounts to reflect that the diverted funds were used either to pay for

materials purchased from Gautier or for payroll expenses. Alexander, therefore, concluded that the expenses for asphalt and payroll were understated by approximately the same amount as gross income and, consequently, the taxable income reported on Construction's original return was basically correct (Pet. App. A5-A6). But, the court of appeals noted (*id.* at A7), "[n]o reason was given * * * as to why those expense accounts [for asphalt purchases and payroll] were selected * * * and no testimony was given as to specific amounts omitted from those accounts." Indeed, Alexander admitted that he did not know the amount of asphalt purchased by Construction from Gautier (II R. 148-163), and, therefore, could not have testified as to the correct amount of the asphalt purchases.

Similarly, with respect to the adjustment to Gautier's income to reflect additional income from Construction for sales of asphalt, the court of appeals noted (Pet. App. A9) that Alexander admitted that, if the figures of the examining agent's report (Exh. 8(A)) were correct, the increase in Gautier's income "was also correct." Alexander contended, however, that the examining agent's adjustment to Gautier's income was improper because the agent failed to increase Construction's asphalt purchases account (Pet. App. A9). The court of appeals first held that, even if this were true, Gautier would not be justified in excluding from its gross income amounts that were admittedly income (Pet. App. A9). Furthermore, the court observed (Pet. App. A9-A10) that "the only evidence in the record" on the point was the agent's testimony, and this testimony was to the effect that these additional purchases were in fact taken into consideration in determining Construction's asphalt purchases.

1. The court of appeals' decision is correct, is essentially factbound, and does not present any issue warranting further review. It is well settled that a taxpayer in a refund

suit not only bears the burden of showing that the deficiency asserted by the Commissioner of Internal Revenue is erroneous in some respects, but must also prove the amount he is entitled to recover. *E.g., United States* v. *Janis*, 428 U.S. 433, 440 (1976); *Lewis* v. *Reynolds*, 284 U.S. 281, 283, modified, 284 U.S. 599 (1932). Here, the court of appeals found, after an exhaustive review of the evidence, that neither Construction nor Gautier had offered any credible evidence in support of their refund claims (Pet. App. A2-A3, A8, A10).

2. Petitioners assert that the court of appeals applied an erroneous standard in reversing the jury verdicts. Essentially, they contend (Pet. 20-23) that the court's reversal is based upon its view of the credibility of their witness, Alexander. This is incorrect. The court rejected Alexander's conclusions that petitioners' taxable incomes were properly stated on their returns because these conclusions were predicated upon assumptions that were legally or factually unsupportable. For example, Alexander testified that it was legally permissible for related corporations to shift income earned by one corporation to another as long as one of them reports the income. As the court of appeals pointed out (Pet. App. A9), this premise violates long established principles of tax law. Similarly, with respect to the specifics of whether Construction's and Gautier's reported income and deductions were correct, Alexander either did not know or offered no testimony on the point (Pet. App. A7, A10-A11). Accordingly, there was no legal or factual basis for Alexander's conclusions or for the jury's verdicts, and the court of appeals correctly reversed. See *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489-490 (1977) (despite the existence of some "conclusory testimony" in support of the respondent's case, this Court held that the

petitioners were nevertheless entitled to judgment notwithstanding the verdict). See also *United States* v. *Generes*, 405 U.S. 93, 106 (1972).[2]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

OCTOBER 1983

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[2]Petitioners allege (Pet. 19) a conflict with *Brady* v. *Southern Ry.*, 320 U.S. 476 (1943). This is without merit. In *Brady*, this Court affirmed the reversal by the North Carolina Supreme Court of a jury verdict. The Court noted (320 U.S. at 480), "[o]ur conclusion is that there was a failure to show in the record any negligence * * *." Similarly here there is no evidence to support petitioners' claims that they overpaid their taxes.

DOJ-1983-10